BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 90-626-C - ORDER NO. 92-89

FEBRUARY 24, 1992

IN RE: Application of Southern Bell Telephone and Telegraph Company to Avail Itself of Incentive Regulation of its Intrastate Operations.	)	ORDER APPROVING REGROUPING AND ORDERING REVENUE REDUCTIONS

This matter comes before the Public Service Commission of South Carolina (the Commission) by way of a tariff filing dated October 8, 1991, filed on behalf of Southern Bell Telephone and Telegraph Company (Southern Bell or the Company). The tariff filing was made pursuant to Order No. 91-595, issued in the instant docket on August 20, 1991.

In Order No. 91-595, the Commission found that Southern Bell was presently earning 13.25% return on equity for its 1989 test year operations. The Commission determined in Order No. 91-595 that the Company's benchmark rate of return should be set at a 13% return on equity. The Commission then determined that before any incentive regulation plan would become effective for Southern Bell, the Company should make an appropriate filing for the Commission's approval to reduce its earnings to the established benchmark. The Commission calculated that a $2,308,995 revenue reduction would be in order. Further, the Commission required that the filing would be noticed to the public and that it would be reviewed to determine the appropriate reduction in the Company's revenues.

The matter was duly noticed to the public, and a public hearing was held in the Offices of the Commission, 111 Doctors Circle, Columbia, South Carolina, the Honorable Marjorie Amos-Frazier, presiding. The Company was represented by William F. Austin, Esquire, and Fred A. Walters, Esquire; AT&T Communications of the Southern States, Inc. (AT&T) was represented by Francis P. Mood, Esquire, and Roger A. Briney, Esquire; MCI Communications, Inc. (MCI) was represented by D. Christian Goodall, Esquire, and Martha P. McMillin, Esquire; the South Carolina Department of Consumer Affairs (the Consumer Advocate) was represented by Steven W. Hamm, Esquire, and Elliott F. Elam, Jr., Esquire; the South Carolina Cable Television Association (SCCTA) was represented by Mitchell M. Willoughby, Esquire, and B. Craig Collins, Esquire; GTE South was represented by M. John Bowen, Jr., Esquire; the Division of Information Management (DIRM) was represented by Craig K. Davis, Esquire; and the Commission Staff was represented by Marsha A. Ward, General Counsel.

The Commission received the testimony of Jerry D. Hendrix for Southern Bell, Ronnie Dowdy for AT&T, and James M. McDaniel, for the Commission Staff. Southern Bell presented Jerry D. Hendrix to give rebuttal testimony.

Positions of the Parties

Southern Bell filed tariff revisions that provide for the regrouping of 28 exchanges in South Carolina. The proposed tariff revisions would regroup 28 of the 86 exchanges in Southern Bell's service area. The estimated annual revenue impact, according to the testimony of witness Hendrix would be $2,576,523 in additional revenues to the Company. Southern Bell proposes this regrouping because it has not regrouped any exchanges since its last general rate increase in 1985 (See, Order No. 85-1, issued January 8, 1985 in Docket No. 84-308-C). To offset this revenue increase, Southern Bell proposes to reduce its Message Toll Service (MTS) rates by $2,594,016. The proposed reductions will more closely aline Southern Bell's and other local exchange companies' rates with those of the interexchange carriers operating in South Carolina. Southern Bell also proposes to restructure and reduce the rates of its Saver Service and WATS Saver Service. The estimated annual revenue impact resulting from the rate reduction and restructure is $354,932. Southern Bell proposes to restructure and reduce its Outward WATS and 800 Service rates. This proposal results in an estimated annual revenue reduction of $979,494. Lastly, Southern Bell proposes to reduce its originating and terminating carrier common line (CCL) rates. The estimated annual revenue reduction and access charges is

$1,002,296.[1] The total estimated annual revenue reduction is $2,354,215.

AT&T supports the regrouping of the 28 exchanges in South Carolina. As to the reduction in the toll charges, AT&T was of the opinion that the appropriate level of toll reduction should be dependent on the level of Switched Access charges. While AT&T supported the reduction in Message Toll Service, AT&T proposed that a price floor for all Southern Bell toll services should be established at the incremental costs which Southern Bell incurs in providing the service. According to witness Dowdy, incremental costs would include Southern Bell's incremental costs of providing the service and the imputation of appropriate access charges. AT&T supported the reduction of MTS rates but was of the opinion that certain Saver Service rates fell below the "price floor" that AT&T thinks is appropriate. AT&T also supported the Company's reduction of the originating and terminating CCL rate but added that if the Commission did not approve the elimination of the time-of-day discount, Southern Bell would need to recalculate a new carrier common line rate.

Commission Staff witness McDaniel provided an alternative concerning the distribution of revenues associated with Southern Bell's filing. Staff agreed with the Company's need to regroup

1. This proposal assumed that the rate changes filed on August 19, 1991, would be approved. By Order No. 92-67, issued in Docket No. 91-532-C, the Commission did not approve the Company's proposal to eliminate time-of-day discounts for Feature Group D (FGD) Switched Access Service.

the 28 exchanges. However, the Commission Staff was of the opinion that instead of reducing MTS rates by the amount of the revenue increase obtained from the regrouping revenue, that the local exchange customers should receive the benefit of the 2.5 million dollars generated through the regrouping of local exchange customers services. Therefore, the Commission Staff propose that a 2.5 million dollar reduction to local exchange rates for both residential and business customers, as well as other classes of local access line service would be more appropriate. The Commission Staff agreed that the remaining 2.3 million dollar revenue reduction should be spread in a manner similar to that proposed by the Company with one exception. Commission Staff witness McDaniel proposed that interLATA FX customers should not be required to pay the carrier common line charge (CCLC) element of its Feature Group A rates on the open end of their service. According to witness McDaniel, because these FX customers are not interexchange carriers, he recommended that they not be required to pay the carrier common line charge rate element included in their access billings from Southern Bell. If the Commission approved Staff's recommendation in this regard, the Company's carrier common line revenues would be reduced by $193,000. The remaining $782,000 should be used to reduce the carrier common line charge for interexchange carriers, according to witness McDaniel. Additionally, the Commission Staff recommended that before the Company may begin operating under incentive regulation, the Commission must first review this filing and determine the appropriate reduction in the Company's revenues.

On rebuttal, Southern Bell took issue with AT&T's assertion that all toll services offered by Southern Bell cover appropriate incremental costs and access charges. Additionally, witness Hendrix rebutted the testimony of Staff witness McDaniel regarding the appropriate ways to reduce rates to offset the revenues which will be generated from the regrouping of exchanges in South Carolina. Although Southern Bell maintains that its original proposal to reduce MTS rates is the most appropriate way to address the increased revenues from the regrouping of the exchanges, witness Hendrix did propose an alternative which would be to reduce or eliminate zone charges and/or PBX trunk rates.

The Consumer Advocate, in its opening statement supported the recommendations made by the Commission's Staff. GTE South, in its cross-examination, was concerned about the impact on the intraLATA toll pool if Southern Bell reduced MTS rates. DIRM pointed out that there would be a benefit if the Commission approved a reduction in PBX trunk and Network Access Register (NAR) rates. MCI addressed the Staff's recommendation on interLATA FX and the compensation plan for intraLATA access, among other issues.

<u>Regrouping of Exchanges and Appropriate Revenue Reduction</u>

The Commission concludes that it is appropriate for Southern Bell to regroup the 28 exchanges proposed in its tariff filing. The Commission recognize that Southern Bell has not regrouped any of its exchanges since its last general rate increase in Order No.

85-1, supra. The 28 exchanges that the Company proposes to regroup presently receive service at a rate cheaper than other exchanges for the same service. The Commission recognizes that in South Carolina, customers pay a monthly amount for their access line based upon their appropriate rate group. In South Carolina, Southern Bell has 7 rate groups, and the rate group size is determined by the number of exchange access and PBX trunks. Southern Bell's proposal recognizes the number of access lines and PBX trunks available to the 28 exchanges and the appropriate rate group for those exchanges. The differential between each rate group amounts to 45¢ for residence access service. Therefore, for each rate group an exchange moves up, its monthly rate will increase for its residence one-party subscribers by 45¢. The corresponding increase for business one-party rate is $1.70 per rate group. All other local exchange access line rates will continue to reflect the current relationship within each rate group. The Commission finds that this increase in rate groups for the 28 exchanges recognizes the calling scope of the customers in each exchange to their appropriate rate group. While the Consumer Advocate expressed concern that this may not be the appropriate docket in which to regroup the 28 exchanges, the Commission finds that it would be inequitable to the other ratepayers of Southern Bell to not recognize and regroup these exchanges. If the Commission were not to allow the regrouping, the other ratepayers of Southern Bell would be, in essence, subsidizing the service of the 28 exchanges. These rate groups for local exchange companies recognize a "value of service" concept, and it is appropriate that the changes in calling scope and access lines of an exchange be recognized at an appropriate period. While the Commission has recognized such regrouping in rate cases, Southern Bell has not had a rate case since 1985, and it would be unfair to not recognize the increase in access lines and PBX trunks to those exchanges at this time. Therefore, the Commission is of the opinion and so finds that it is appropriate to regroup the 28 exchanges in this proceeding.

With the regrouping of the 28 exchanges, comes an estimated annual revenue increase of $2,576,523. While Southern Bell recommends a reduction in MTS rates or as an alternative reduce zone charges and/or PBX trunk line rates, to counter-balance the revenue increase, the Commission Staff proposes an across the board rate reduction for basic service rates. In addressing the Company's proposal to reduce MTS rates, the Commission finds that it is not appropriate to reduce toll rates to counter-balance a revenue increase that is produced by an increase to local basic service rates. It is more appropriate to match the increase in local service revenues to a decrease in the same local service revenues. Additionally, the Commission is not convinced by Southern Bell's argument that more ratepayers would benefit from the reduced MTS toll rates. As was pointed out on cross-examination of witness Hendrix, only 40% of Southern Bell's customers make any toll calls in a given month. Witness Hendrix testified that over an 8 month period, 92% of Southern Bell's customers do use toll service. However, the Commission is more impressed with the fact that 60% of the Company's customers do not make any toll calls in a given month. The Commission would rather see a benefit to the ratepayers that would be more meaningful. The reduction in MTS rates as proposed would only be 3.5%.[2] Under the Staff's proposal, the average reduction in local basic rates for residential customers would be 13¢ per month and the average reduction for business customers would be 43¢ per month.

While any rate decrease to local ratepayers would be significant, the Commission has examined the alternate proposal of Southern Bell that was put forth by witness Hendrix's rebuttal. It has long been the Commission's policy that, where possible, a local exchange company's zone charges should either be reduced or eliminated. Under the alternative proposed by Southern Bell, over 191,000 of Southern Bell's 1 million plus access lines in South Carolina are subject to zone charges. Depending on the location of the customer, zone charges range from 50¢ to $5.00 per month per access line. Many local exchange companies have, over time, attempted to eliminate or reduce zone charges. While Staff's recommendation to reduce basic local rates across the board for all ratepayers has much merit, the Commission finds that the alternative proposed by Southern Bell to reduce or eliminate zone charges is consistent with the Commission's policy in regard to

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2. Of course, the Company may reduce its MTS rates at any time with the proper notice pursuant to the Commission's decision in Order No. 89-988, issued in Docket No. 89-181-C.

zone charges. Additionally, the Commission views the elimination or reduction of zone charges which will benefit many rural customers as a better alternative than DIRM's proposal to reduce PBX trunk or NAR's rates, which would primarily benefit the business customer.

While not all ratepayers will benefit from a reduction or elimination of zone charges, those customers who presently pay such charges will see a significant and meaningful reduction in their monthly bill for local service. The impact of the elimination or reduction of zone charges to the customer paying such zone charges is more significant than the average monthly reduction of 13¢ for residential service and 43¢ for business service. Therefore, the Commission finds that it is more appropriate to reduce or eliminate zone charges to the extent of the 2.5 million dollars collected due to the approved regrouping. Southern Bell is hereby required to file tariffs which eliminate or reduce zone charges to reflect these findings. The Company should strive to eliminate as many zones as possible and to significantly reduce the zone charges to those zones maintained.

As to Southern Bell's contention during the proceeding that local basic rates are priced below cost, the Commission makes no finding on that matter. The Commission does find, however, that this proceeding is not an appropriate proceeding to consider this matter. While Southern Bell placed a cost study into the record of this proceeding, the Commission finds that it is not necessary to reach the issue of the appropriate level of costs for local basic service in this proceeding. Additionally, Southern Bell did not present the cost study for approval and the Commission does not consider it necessary to consider the cost of service study presented.

Restructure and Reduction of Saver Service, WATS Saver, Outward WATS, and 800 Service Rates

The Commission Staff agreed with the Company's proposal to restructure and reduce its Saver Service, WATS Saver, Outward WATS, and 800 Service rates. The total reduction in the Company's revenues would be $1,334,442 by this proposal. AT&T was of the opinion that Southern Bell's proposed rates for Saver Service (WATS Saver Service) from 250 hours through 7500 hours do not cover the appropriate access charges. However, Southern Bell provided testimony on rebuttal that refuted this allegation. According to the rebuttal testimony of witness Hendrix, in every instance, the rates of the competitive toll service are at a level in excess of access charges where originating traffic is carried over special access and terminating traffic is carried over switched access. According to witness Hendrix, in the development of these options, and for every toll service, Southern Bell ensures that the toll service rates reflect cost of service, the customer's willingness to pay, competitiveness of the toll market place, the maximum contribution from the toll service offering in order to underwrite local exchange service, and appropriate access charges. Special access on the originating end and switched access on the terminating end is not a new concept. According to witness Hendrix, it is appropriate to include special access on the originating end and switched access on the terminating end because these are the services used by interexchange carriers in providing their high volume toll service offerings. The Commission finds that Southern Bell's pricing of its toll services is appropriate. Therefore, the Commission hereby approves the restructuring and reduction of Saver Service, WATS Saver, Outward WATS, and 800 Service rates as proposed in Southern Bell's filing. This amounts to a revenue reduction of $1,334,442.

Reduction of Originating and Terminating Carrier Common Line Rates

While the Commission Staff basically agreed with the Company's proposal to reduce originating and terminating carrier common line charge rates, the Commission Staff proposed to eliminate the carrier common line charge rate element included in foreign exchange (FX) customers' access billings from Southern Bell. The carrier common line charge element is a switched access element used to receive support from the interexchange carriers for the Company's non-traffic sensitive cost and should not be applied to an end-user customer. FX customers are not interexchange carriers for the purposes of Southern Bell's tariff and should not be required to pay these charges. The Commission finds that Staff's recommendation is appropriate and that interLATA FX customers should not be required to pay the carrier common line charge rate element included in their access billings. With the approval, the Company's carrier common line charge revenues would be reduced by approximately $193,000. The Commission finds that the remaining $782,000 should be used to reduce the carrier common line charge for interexchange carriers on the originating and terminating end as proposed by the Company. The Company shall file tariffs and supporting documents to reduce the originating and terminating carrier common line charge rate element to the level corresponding with the CCLC revenue reduction required herein. Further, the Company is required to reduce its 1988 capped revenue used for calculating the originating CCLC rate in Docket No. 88-472-C consistent with the reduction required herein.

As to MCI's request that the Commission take Judicial Notice of Order No. 85-187, issued in Docket No. 86-793-C, the Commission so notes the Order and its requirement of the review of the compensation rate paid for unauthorized intraLATA usage. MCI may raise this issue by the filing of appropriate pleadings, but it is not appropriate to consider the issue in the instant Docket.

Incentive Regulation

With the above approved reductions in the Company's 1989 test year revenues, the Commission finds that the Company's earnings for the 1989 test year have been reduced to the Commission approved benchmark of 13%. As stated in Order No. 91-595, issued in the instant Docket, the Commission must ensure that when Southern Bell begins its operations under incentive regulation that it begins such with its earnings at the benchmark rate of return on equity, i.e., 13%. By reducing the test year earnings to 13%, the Commission recognizes that over two years has elapsed between the 1989 test year and the present. During that time, the Commission has had available to it the yearly earnings reported on a quarterly basis to the Commission. These earnings are not subject to incentive regulation, and thus, the Commission must review this period to ensure that the Company has not been over earning under the Commission's traditional ratemaking review.[3] The Commission finds that the Company may begin operating under the Commission's approved Incentive Regulation Earnings Sharing Plan. The Commission finds that it is appropriate that the incentive regulation period be one that is administratively easy to review. Therefore, the Commission finds that the 12 month review period will be based on calendar year information. Southern Bell may commence incentive regulation operations effective January 1, 1992 and its review period will be for the 1992 calendar year. Any excess earnings prior to January 1, 1992, if any, will be subject to the Commission's traditional regulatory review and appropriate measures, if necessary, will be taken by the Commission after review.

IT IS THEREFORE ORDERED:

1. That Southern Bell regroup the 28 exchanges proposed in its tariff filing.

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3. The Commission has, by letter dated February 6, 1992, notified Southern Bell that its quarterly report for the twelve month period ending September 30, 1991 reflects a return on equity of 15.37% for Southern Bell's South Carolina operations and has given the Company 30 days to respond.

2. That Southern Bell file tariffs for Commission approval which eliminate or reduce to the extent possible zone charges to reflect the revenues collected by Southern Bell due to the approved regrouping herein.

3. That Southern Bell file tariffs for Commission approval to reflect the Commission's findings consistent with Staff's recommendations concerning the reductions to Saver Service, WATS Saver, Outward WATS, 800 Service, and Feature Group A rates for interLATA FX Services.

4. That the Company file new tariffs for Commission approval reflecting the Commission's findings concerning the reduction in originating and terminating carrier common line charge rates.

5. That all required tariffs should be filed within 30 days of the date of this Order.

6. That the Company may begin incentive regulation under the Commission's approved Earnings Sharing Plan effective January 1, 1992.

7. That the Company's earnings prior to January 1, 1992 will be reviewed by the Commission and appropriate action, if necessary, will be taken. Any action taken by the Commission in this regard will be for that period prior to 1992 subject to the Commission's traditional regulatory oversight.

8. That this Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

VICE Chairman

ATTEST:

Executive Director

(SEAL)